Overview and implications for Swiss banks & financial services providers

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EU Mandatory Disclosure Rules for Intermediaries ("DAC 6")

On 25 June 2018, the Council of the European Union formally adopted new mandatory disclosure rules ("MDRs") for qualifying intermediaries and relevant taxpayers, the latest in a series of EU initiatives in the field of automatic exchange of information in tax matters. The new rules will require financial intermediaries (incl. banks) and, in certain circumstances, relevant taxpayers, to disclose certain information on reportable cross-border tax arrangements if the arrangement meets one or more so-called hallmarks, i.e. certain criteria that are seen to present an indication of a potential risk of tax avoidance. Although the rules will only apply in the EU, there are various ways in which Swiss banks, trust companies, asset managers and financial services providers can be affected too. They should therefore carefully analyse the potential impact the new rules may have on their organization and determine appropriate steps to meet their potential obligations.

1. Overview
As of 1 July 2020, qualifying intermediaries (or, in certain cases, the relevant taxpayer) will be required to disclose information on reportable cross-border tax arrangements to their authorities within 30 days of the earlier of when the arrangement is made ‘available for implementation’, ‘ready for implementation’ or actually implemented.

Arrangements entered into after the Directive has entered into force on 25 June 2018 will also have to be disclosed as part of a delayed reporting requirement by 31 August 2020.

2. Which taxes will be covered by DAC 6?
The scope of DAC 6 includes all taxes levied by (or on behalf of) a Member State, with the exception of VAT, customs duties, excise duties and compulsory social contributions. It therefore includes corporate and personal income taxes, inheritance and gift taxes, financial transaction taxes, stamp duties and insurance taxes. The Directive further requires reporting of cross-border arrangements which may have the effect of undermining the reporting of financial account information and those that aim to make beneficial owners unidentifiable.

3. Which transactions will be affected by DAC 6?
DAC 6 will cover all arrangements that are cross-border, i.e. that involve participants resident in either more than one EU member state or a member state and a third country. The arrangement must further meet one or more of a set of hallmarks, i.e. certain features that are considered to present an indication of a potential risk of tax avoidance. Certain hallmarks further require that the so-called main benefit test is satisfied, i.e. that one of the main objectives of the arrangement is to obtain a tax advantage.

The hallmarks are structured into the following categories:

- Category A – Generic hallmarks linked to the main benefit test: arrangements that give rise to performance fees linked to a tax advantage or involve mass-marketed tax optimization schemes.

Example – Hallmark A.3_ Standardized documentation

A Swiss private bank maintains an asset management division in Luxembourg. The Luxembourg asset management division offers an investment fund solution specifically addressed to create a tax deferral effect for Spanish investors. Where offered on a “standardised” basis (i.e. not specifically tailored to each customer), that arrangement could meet the criteria of hallmark A.3.

Determining the DAC 6 implications in an investment fund context will be complex and may require a comprehensive analysis of a bank’s/ asset manager’s financial products to identify which of them meet the criteria of hallmark A.3.
– Category B – Specific hallmarks linked to the main benefit test: this includes certain tax planning features, such as buying a loss-making company to exploit its losses in order to reduce tax liability. Another example would involve arrangements aimed at converting income into capital in order to obtain a tax benefit.

Example – Hallmark B.2: conversion of income into capital

A relationship manager of a Swiss bank advises a German resident client to invest part of his funds through a life insurance policy that is preferentially taxed in Germany.

This investment structure should meet the criteria of hallmark B.2, as it is a cross-border arrangement with an EU-resident client, and the tax advantage derived through the arrangement is likely to meet the main benefit test.

– Category C – Specific hallmarks related to cross-border transactions; some of these hallmarks are also subject to the main benefit test: for example, deductible cross-border payments between associated enterprises where the recipient is essentially subject to no tax, zero or almost zero tax. Another hallmark is about deductions for the same depreciation on an asset claimed in more than one jurisdiction.

Example – Hallmark C.1: transactions involving zero-tax or blacklisted jurisdictions

A private bank maintains presences in the Cayman Islands (a zero-tax jurisdiction) and the United Arab Emirates (“UAE”, currently a black-listed jurisdiction). The Relationship Managers of these entities acquire clients that then invest in the bank’s Luxembourg funds. The Cayman and UAE entities are remunerated for these services. The services constitute a cross-border arrangement between related entities, one of which is resident in the EU, the other one of which is resident in a zero-tax/blacklisted jurisdiction. The arrangement is therefore reportable under DAC 6.

Hallmark C.1 is relevant in the context of a bank’s group transactions between related entities in relevant jurisdictions. A bank should therefore carefully analyse any group-internal transactions involving entities in a zero-tax or blacklisted jurisdiction and an EU member state.

– Category D – Specific hallmarks concerning the automatic exchange of information and beneficial ownership: an arrangement is reportable if it has the effect of undermining the rules on anti-money-laundering, transparency of beneficial ownership or the automatic exchange of information.

– Category E – Specific hallmarks concerning transfer pricing: these include the use of unilateral safe harbours, and the transfer of hard-to-value intangible assets when no reliable comparables exist and the projection of future cash flows or income are highly uncertain.

4. Who is required to report?
The primary reporting obligation under DAC 6 lies with the intermediary. An intermediary is defined as any person that designs, markets, organises or makes available for implementation or manages the implementation of a reportable cross-border arrangement. The term also includes any person undertaking to provide, directly or by means of other persons, aid, assistance or advice in relation to the above.

In the following cases the reporting obligation shifts to the taxpayer:

– The intermediary is exempt by virtue of legal professional privilege;
– There is no intermediary; or
– The intermediary is located outside of the EU.

5. What information will need to be reported?
The following information will need to be reported under DAC 6:

a) Identification of the taxpayers and intermediaries involved,
b) Details of the hallmarks that generated the reporting obligation,
c) A summary of the arrangement,
d) The date of the first step in implementing the reportable arrangement,
e) Details of the relevant domestic tax rules,
f) The value of the arrangement,
g) The identification of the member state of the relevant taxpayer(s) and any other member states which are likely to be concerned by the reportable cross-border arrangement,
h) The identification of any other person in a member state likely to be affected by the reportable cross-border arrangement, indicating the corresponding member state.

6. How will Swiss banks be affected?
While DAC 6 will only apply within the EU, it is nevertheless important for Swiss banks to analyse how they can potentially be affected by the rules. Swiss intermediaries should in particular analyse the following key areas of implications:
– Swiss banks with EU resident clients will, at a minimum, need to inform their EU resident clients about their potential reporting obligations. Given the wide definition of the term “intermediary”, this will comprise cross-border arrangements offered by Swiss banks themselves as well as situations where a Swiss bank acts as an advisor with regards to arrangements offered by third parties.
– Swiss banks with related entities in the EU will need to analyse whether the services offered to clients by those entities are potentially reportable;
– Swiss banks with related entities in the EU will further need to analyse potential reporting obligations resulting from transactions within the group.

7. How KPMG can assist you
KPMG can offer you a variety of services to help your organization navigate through the DAC 6 requirements.

Training
We can provide training sessions on the DAC 6 requirements, tailored to the specific requirements of your organization.

Impact assessment
We can perform a detailed assessment of the potential impact of DAC 6 on your organization. This includes an in-depth analysis of the products and transactions (both in-house and with regards to clients) that could be in scope, as well as a comparison of the detailed requirements across affected jurisdictions.

Policies and processes
Once the impact of DAC 6 on your organization has been determined, we can assist you in the implementation of appropriate policies, amending processes accordingly and implementing required mechanisms for ongoing monitoring and potential reporting.

KPMG MDR Processor
The KPMG MDR Processor is a ready-to-implement and easy-to-use DAC 6 reporting solution, covering the reporting requirements in all EU members states.